Community Foundation
Research and Training Institute

Knowledge Nugget #3: The Variance Authority

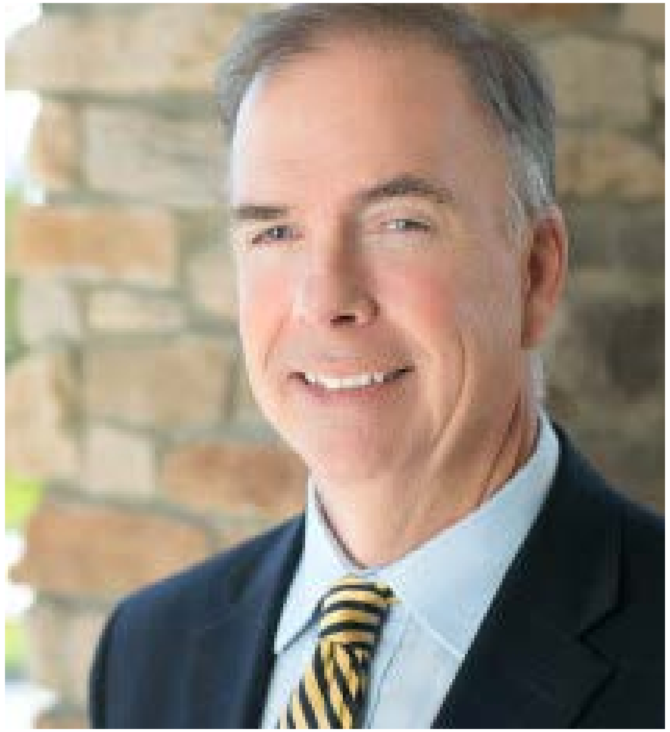
The Variance Authority

- The Single Entity Requirement
- What Is the Variance Power?
- Court Cases and Variance Power Limits
- UPMIFA and Variance Power
- Variance Power and Investment Management

My Contact Information

David Bennett

- Cell: 260-804-5617
- Email: cfrtinstitute@gmail.com
- Website: www.cfrti.com



The Single Entity Requirement

More than 50 years ago, Congress passed legislation which gave community foundations more favorable tax treatment that private foundations.

Part of the reason for this was that a community foundation has the capacity to manage hundreds of charitable funds. In the absence of a community foundation, those funds might end up as individual private foundations. Managing hundreds of charitable funds in a single entity is more efficient than creating hundreds of private foundations.

The Single Entity Requirement

But to be treated as a single entity for tax purposes, there are several things that a community foundation should have:

- It should be known as a community foundation
- It should have just one article of incorporation (or trust document, if a trust) and set of bylaws
- It should have a common governing body
- It should have variance power

Variance Power

What is Variance Power?

Variance Power gives a community foundation the unilateral power to change the charitable purpose of a fund if circumstances have sufficiently changed to make the original restriction inappropriate.

The most common circumstance for using Variance Power is when a charity goes out of existence. If a fund supporting that charity is held at the community foundation, the board of the community foundation can redirect the funds to a charitable use that most closely approximates the original intent of the fund.

Variance power has it's roots in a concept relating to trusts known as the *Cy Pres Doctrine.*

What is Cy Pres Doctrine?

Cy Pres Doctrine is a legal concept that gives courts the power to interpret the terms of a will, gift, or charitable trust. This doctrine will become active if the intended wishes or conditions of the original document cannot be carried out, be legitimately interpreted literally, or legally performed. Cy Pres gives the court the flexibility to understand the perceived intent of the donor or testator and implement their wishes.

The term has its origin is an old French phrase, *cy pres comme possible* which, in translation, means "as near as possible." If it were not for this power, there would be instances in which the phrasing in the document would make it null and void, legally, and thus impossible to implement.

Variance Authority Language in a Fund Agreement

All of your funds **must** have language granting your community foundation variance authority. Typical language looks something like this:

*The Board of Directors of the Community Foundation may modify any restriction or condition on the distribution of assets for any specified charitable purpose or to specified organizations, if, in their sole judgment, such restriction becomes, in effect, **unnecessary, incapable of fulfillment, or inconsistent with the charitable needs of the area** served by the Foundation.*

What If a Donor Doesn't Want This Language in Their Fund Agreement?

- A donor creating a fund may object to including the Variance Authority language in a fund agreement.
- However, **<u>all of your funds must have the Variance Authority language</u>**
  - The only exception to this is a supporting organization, which is a separate corporation discussed in a previous seminar
- You can reassure the donor that your community foundation will, to the best of it's ability, try to adhere to the donor's charitable intent. But the final decision must rest with the board of the community foundation.

Limits to Variance Authority Power

While the Variance Authority would certainly seem to give the board of a community foundation wide discretion in using this power, in the two most notable court cases that have occurred in the field courts have ended up limiting a community foundation's ability to unilaterally use the Variance Authority.

These two cases involved the New York Community Trust and The San Francisco Foundation.

NY Community Trust

- In 1971, the New York Community Trust's board chose to reallocate the annual distribution from six trust funds, including one created by John D. Rockefeller, Jr.
- They cited tax law changes and existing anti-poverty programs as the reason for diverting funding away from a number of charities, including one known as the Community Service Society.

NY Community Trust

- In 1993, the Community Service Society sued, asserting that the New York Community Trust abused its power and unfairly diverted the annual payouts.
- While the judge ruled that community foundations had the right to divert funds using the variance authority, the ruling narrowed the circumstances when that power could be used.
  - *" … the variance power must be grounded in a change of circumstance that negatively affects the designated charity to such a degree that it would be likely to prompt a donor of the fund to re-direct it."*
- In addition, the state attorney general at the time took the position that, when the variance authority is used, community foundations should report that use to them.

San Francisco Foundation

- Beryl Buck, a childless widow, died in 1975 when she was 75 years old.
- She left $10 million in stock in the Belridge Oil Company, stipulating in her will that the income was to be used exclusively for ''nonprofit charitable, religious or educational purposes in providing care for the needy in Marin County, Calif., and for other nonprofit, charitable, religious or education purposes in that county.''
- The San Francisco Foundation was asked to administer the Buck fund.
- Just four years later, the stock in Belridge became much more valuable when it was purchased by Shell Oil Company. The Buck fund was now worth more than $250 million, and the corresponding annual payout rose substantially, as well.

San Francisco Foundation

- Marin County was a substantially wealthier community than San Francisco and the San Francisco Foundation, citing this fact, started to use some of the income from the Buck fund for anti-poverty programs in San Francisco.
- Residents in Marin County sued, and they were joined by the state's attorney general.
- Eventually the judge ruled that the San Francisco Foundation could not base it's use of the variance authority on the relative wealth of the two communities. Rather, they had to prove that it would be illegal, impracticable or impossible to spend all of the annual distributions in Marin County.
- Using that standard, the residents in Marin County prevailed.

Variance Authority under UPMIFA

Nearly all states have approved laws known as UPMIFA– Uniform Prudent Management of Institutional Funds Act. UPMIFA will be discussed in further detail in an upcoming seminar.

In many states, UPMIFA issued new guidelines regarding the potential use of the variance authority by a community foundations. (Note that while model guidelines on UPMIFA were published, each state was free to enact UPMIFA as they saw fit so this language may differ in your state.)

Variance Authority under UPMIFA

Typical Language

If an institution determines that a restriction found in the gift instrument is unlawful, impracticable, impossible to achieve, or wasteful, the institution may release or modify a restriction without donor consent or court approval if all of the following conditions are met:

1. The institutional fund is less than $25,000;

2. The fund is more than 20 years old;

3. The money will be used with consistent charitable purposes; and

4. 60 days have passed since the Attorney General received notice of the release or modification.

Variance Authority and Investment Managers

In order to be considered a single entity, a community foundation must also retain final authority on the selection of investment managers.

Many community foundations allow a donor to recommend an investment manager to manage the assets of a fund created by the donor.

However, a community foundation must retain the right to change that investment manager if certain conditions are met.

Does Variance Authority Apply to Investment Management?

- A Community Foundation must have the authority to change investment managers in two circumstances:
  - If manager has breached a fiduciary duty under state law.
  - If manager has failed to produce a reasonable return of net income over a reasonable period of time.
- An irrevocable relationship with an investment advisor would *probably* constitute a "material restriction" that would prevent the trust from qualifying as a component fund.

My Contact Information

That's it for this Knowledge Nugget. If you want to test what you learned, there's a short quiz located elsewhere on this website.

If you have any questions or comments, please contact me using this information

David Bennett

- Cell: 260-804-5617
- Email: cfrtinstitute@gmail.com
- Website: www.cfrti.com

Keep up the good work … what you are doing for your community is <u>so important.</u>